

Internal Revenue Service (I.R.S.)

Private Letter Ruling

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Section 7871 -- Indian Tribal Governments Treated As States For Certain Purposes  
7871.00-00 Indian Tribal Governments Treated As States For Certain Purposes  
7871.03-00 Tax Exempt Bonds

CC:TEGE:EOEG:TEB  
PLR-153149-05

Legend

Tribe =  
Authority =  
State =  
Year 1 =  
Year 2 =  
w =  
x =  
y =  
z =

Dear

This letter is in response to your request on behalf of the Tribe for a ruling that ownership and operation of a government office building, emergency services building, cultural center and museum, and infrastructure improvements (all of which are described below) by the Tribe on tribal land constitute essential governmental functions within the meaning of [§§ 7871\(c\)\(1\)](#) and [7871\(e\) of the Internal Revenue Code](#) (the "Code").

FACTS

The Tribe is listed as an Indian tribal government in [Rev. Proc. 2002-64, 2002-2 C.B. 717](#), which lists Indian tribal governments that are to be treated similarly to states for specified purposes under the Code.

The Tribe makes the following representations. The Federal government holds a w-acre reservation in trust for the Tribe in the State (the Reservation). The Reservation was used for tribal housing until Year 2, when a casino (described below) was built on the land. The Reservation also has a tribal burial ground, and sewage, water, and drainage systems. Water from the water system is available to the local city for land fires in the area. A road on the Reservation (the Road) that was constructed approximately x years ago, which is many years before the casino was constructed, runs from a state highway (the State Highway) into and through the Reservation. This road, like other roads on reservations, is considered under Federal law to be a public road for providing access to the Reservation.

In Year 2, the Tribe opened a casino (the Casino) on the Reservation. Within the next two years, the Tribe plans to begin a project to enlarge and improve the Casino, using funds other than tax-exempt bonds. The Road provides access to the Casino from the State

Highway.

The Tribe recently acquired a y-acre parcel of land located contiguous to the Reservation (the Acquired Property) that the Tribe expects will also be held in trust for the Tribe by the Federal government.

The Tribe plans to develop the Acquired Property and further develop the Reservation in the near future. On the Acquired Property, the Tribe plans to construct an emergency services building, a government office building, a small number of residential houses, and a vineyard. The Tribe expects construction to begin on the government office building within three years and on the emergency services building within two years. The vineyard should be completed within the next year. On the Reservation, the Tribe proposes to construct a cultural center and museum, with construction beginning within the next three years. The Tribe also plans to improve the infrastructure on the Acquired Property and the Reservation (together, the Tribal Land). Improvements to the infrastructure will precede construction of the proposed buildings. The Tribe expects that it will meet the requirements of [§ 1.148-2\(e\)\(2\) of the Income Tax Regulations](#), including the requirement that completion of the proposed projects and the allocation of the net sale proceeds of the issue to expenditures will proceed with due diligence.

The Tribe proposes to finance the emergency services building, a portion of the government office building, the cultural center and museum, and the infrastructure improvements with bonds described in § 103 of the Code (the Bonds). The Bonds will be issued by the Tribe and the proceeds will be loaned to the Authority, an unincorporated governmental instrumentality of the Tribe.

#### Proposed Buildings

The emergency services building will be used as a headquarters for the Tribe's police and fire operations. The government office building will be used for government offices and for offices for vineyard employees. The portion of the government office building used for offices for vineyard employees will not be financed with the Bonds. The portion that will be financed with the Bonds (the Government Office Building) will be used to house various tribal government departments, including tribal administration, housing, fiscal, human resources, environmental, and community development programs.

The cultural center and museum will be approximately one-third the size of the existing Casino and will contain an exhibit area, a lobby and reception area, a gift shop, a theater, activity rooms, an office suite, and a reception/meeting room. The office space will be used to house tribal cultural resource staff and the reception/meeting room will be used for a variety of tribal and non-tribal civic functions. The portion of the cultural center and museum that will be available to nongovernmental persons will be used in a manner that meets § 1.141-3(d)(3)(i) or otherwise does not give rise to impermissible private business use. There are thousands of museums owned and operated by public authorities (which for this purpose does not include 501(c)(3) organizations) and every state owns and operates, directly or indirectly, one or more museums. Looking at a reasonably sized sample of these municipal museums, most of the museums in the sample were established before 1990. The Tribe has also submitted evidence that tax-exempt financings have been used to finance municipal museums.

None of the buildings that will be financed with the Bonds are intended to be used for commercial or industrial purposes or as revenue generating facilities.

#### Proposed Infrastructure Improvements on the Tribal Land

Improvements to the infrastructure will include improvements to the Road, a new road, and improvements to the water, sewage and drainage systems. The Road improvements will include improving access from the State Highway to the Road; splitting a portion of the Road into two separate one-way roads to improve traffic handling capacity, provide access to the proposed cultural center and museum, and accommodate visitor access to the Reservation; adding a loop road around the Casino; and making changes to improve

access to the Casino's various parking and bus dropoff facilities. These improvements will initially mainly be used to provide the public with greater access to the Casino and to provide access to the water treatment facilities, but will eventually also provide access to the cultural center and museum.

The Tribe will also add a new road between the State Highway and the Road that will go through the Acquired Property passing the government office building, the emergency services building, the houses, and the vineyard (the New Road). The New Road will be gated where it joins the Road with access limited to members of the Tribe, emergency vehicles, and access for emergency purposes. Access to the Acquired Property for the general public will be provided by a new intersection joining the New Road to the State Highway.

Improvements to the water system will include the addition of wells, a storage tank, and water lines. Improvements to the sewer system will include construction of additional storage or treatment facilities. With the improvements, these systems should meet all of the future needs of the Tribal Land, including the needs of the government office building, the cultural center and museum, and the emergency services building. However, initially, the improvements will mainly be used by the Casino and the users of the Casino. Use of the water and sewer system is governed by Tribal ordinances, which prohibit any customer from having special legal entitlements to service; all customers will have equal rights to the service.

Improvements to the drainage system will include relocation of, and modifications to, the system to accommodate the changes to the Road, and the addition of one or more basins to meet storm water retention requirements for the Tribal Land.

## LAW AND ANALYSIS

[Section 7871\(a\)](#) of the Code provides that an Indian tribal government is to be treated as a State for certain purposes of the Code. [Section 7871\(a\)\(4\)](#) provides that an Indian tribal government is to be treated as a State "subject to subsection (c), for purposes of § 103 (relating to State and local bonds)." [Section 7871\(c\)\(1\)](#) provides that "section 103(a) shall apply to any obligation (not described in paragraph (2)) issued by an Indian tribal government (or a subdivision thereof) only if such obligation is part of an issue substantially all of the proceeds of which are to be used in the exercise of any essential governmental function." [Section 7871\(e\)](#) provides that "[f]or purposes of this section, the term essential governmental function' shall not include any function which is not customarily performed by State and local governments with general taxing powers."

[Section 7871](#) was originally enacted in 1982 by The Indian Tribal Government Tax Status Act, [Pub. L. No. 97-473](#) (1983), 96 Stat. 2605. In the legislative history to that Act, the Senate Finance Committee indicated that tax-exempt bond financing was not intended to be available to Indian tribal governments for "commercial or industrial activities (or other activities other than essential governmental functions)." [S. Rep. No. 97-646, at 13-14 \(1982\)](#). The House Conference Report provides specific examples of functions that are essential governmental functions, listing schools, streets, and sewers. H.R. Rep. No. 97-984, at 16-17 (1982) (Conf. Rep).

[Section 7871\(e\)](#) was added to the statute by The Omnibus Budget Reconciliation Act of 1987, [Pub. L. No. 100-203, 101 Stat. 1330](#), § 10632(a) (1987). In the legislative history to this provision, the House Ways and Means Committee criticized 1984 Temporary Treasury Regulations interpreting the term essential governmental function in [§ 7871\(c\)](#) for including certain activities eligible for Federal funding in that definition. The House Ways and Means Committee stated that the reason for this amendment was that the Committee was concerned about reports that Indian tribal governments were issuing tax-exempt bonds for interests in "commercial and industrial enterprises." The Committee further included the following statement about [§ 7871\(e\)](#):

The bill clarifies that, with respect to bonds issued by Indian tribal governments, the term 'essential governmental function' does not include any governmental function that is not customarily performed (and financed with governmental tax-exempt bonds) by State and

local governments with general taxing powers. For example, issuance of bonds to finance commercial or industrial facilities (e.g., private rental housing, cement factories, or mirror factories) which bonds technically may not be private activity bonds is not included within the scope of the essential governmental function exception.

Additionally, the committee wishes to stress that only those activities that are customarily financed with governmental bonds (e.g., schools, roads, governmental buildings, etc.) are intended to be within the scope of this exception, notwithstanding that isolated instances of a State or local government issuing bonds for another activity may occur.

[H.R. Rep. No. 100-391, at 1139 \(1987\).](#)

The 1987 Conference Committee adding the limited manufacturing facility provision of [§ 7871\(c\)\(3\)\(A\)](#), noted that:

A facility which does not qualify as a manufacturing facility for purposes of this provision may nonetheless be financed with tax-exempt bonds issued by a tribal government provided that the facility satisfies the 'essential governmental function' standard (i.e., the facility is comparable to facilities that are customarily acquired or constructed and operated by States and local governments). For example, a building used for offices for a tribal government itself would be comparable to State or local government office buildings, and therefore, could be financed with tax-exempt bonds. As another example, a lodge owned and operated by a tribal government may be eligible for tax-exempt financing if it is comparable to lodges customarily owned and operated by State park or recreation agencies.

H. R. Rep. No. 100-495, at 1012 n.5 (1987)(Conf. Rep).

We interpret [§ 7871\(c\) and \(e\)](#) to provide that an activity will be considered an essential governmental function that is customarily performed by State and local governments if:

(1) there are numerous State and local governments with general taxing powers that have been conducting the activity and financing it with tax-exempt governmental bonds, (2) State and local governments with general taxing powers have been conducting the activity and financing it with tax-exempt governmental bonds for many years, and (3) the activity is not a commercial or industrial activity.

In this case, ownership and operation of the Bond financed facilities represent essential governmental functions. Ownership and operation of the facilities is not a commercial or industrial activity. Almost all of the financed facilities, i.e., the improvements to the Road, new Road, drainage, and sewer and water system, the Government Office Building, and the emergency services building are public works projects, which are the same or substantially the same as examples in the legislative history of projects that meet the essential governmental function test of [§ 7871\(e\)](#).

While the cultural center and museum may be viewed as a government building, which is described as an essential governmental function in the legislative history, the Tribe has also represented sufficient facts for us to conclude that (1) there are numerous State and local governments with general taxing powers that have been owning and operating museums and financing them with tax-exempt governmental bonds, and (2) State and local governments with general taxing powers have been owning and operating museums and financing them with tax-exempt governmental bonds for many years. The Tribe has represented that there are thousands of museums owned and operated by public authorities. Moreover, the Tribe, testing a reasonable sampling of municipally-owned museums, found that State and local governments have owned and operated museums in that sample for decades. The Tribe also has submitted information to demonstrate that tax-exempt financings have been used to finance publicly-owned museums.

We also conclude that construction and operation of the infrastructure improvements will be an essential governmental function even though the improvements will be used primarily by the Casino and the vineyard. An activity does not become a commercial or industrial activity merely because that activity benefits a commercial or industrial operation. Whether an activity is a commercial or industrial activity requires consideration of all the facts and circumstances. On this point, the private business use rules, while not controlling, provide useful analysis. Under § 141, the expectation that a private business

will make primary use of a facility will not result in private business use if that facility is intended to be available and in fact is reasonably available for use on the same basis by the general public. See § 1.141-3(f)(example 11) (bonds used to construct road reasonably expected to be used almost entirely by private business not private activity bonds because private business has no legal entitlement to road and road will be available for use without restrictions to all users, including general public). In this case, the Tribe has represented that the infrastructure improvements will be used for a variety of public uses that are not commercial or industrial activities and the governmental user, and indeed the general public, will have the same access to the infrastructure improvements as the Casino and the vineyard. The Tribe has described an entire development project for the Tribal Land that includes construction of an emergency services building, the Government Office Building, and the cultural center and museum. The infrastructure improvements are being sized to meet the needs of these buildings and all future needs of the Tribal Land, along with the needs of the Casino. It is reasonable to expect that when infrastructure is being constructed on land that will be used for a variety of uses, the infrastructure will be used by certain users of the land before being used by other users of the land. Moreover, here the Tribe expects that the proposed buildings will use the infrastructure in the relatively near term. The Tribe represents that construction on the proposed buildings will start within three years and will proceed with due diligence. Thus, even though the governmental users will begin to use the improvements later than the Casino, the ownership and operation of the infrastructure improvements is still an essential governmental function within the context of the entire project that the Tribe represents it will complete. Based on all the facts and circumstances represented by the Tribe, we conclude that the Casino's and vineyard's use of the infrastructure improvements does not cause those facilities to be used for other than an essential governmental function.

## CONCLUSION

Accordingly, we conclude that owning and operating the Government Office Building, emergency services building, cultural center and museum, and infrastructure improvements described herein constitute essential governmental functions within the meaning of [§§ 7871\(c\)\(1\)](#) and [7871\(e\)](#) of the Code.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

The rulings contained in this letter are based upon information and representations, including but not limited to, representations regarding development that is expected on the Tribal Land, submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Assistant Chief Counsel (Exempt Organizations/Employment Tax/ and Government Entities)

By:

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This document may not be used or cited as precedent. [Section 6110\(j\)\(3\) of the Internal Revenue Code.](#)

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